BANK POLICY INSTITUTE

July 10, 2024

Ms. Jennifer Fain
Federal Deposit Insurance Corporation Office of Inspector General
3501 Fairfax Drive
Arlington, VA 22226

Dear Ms. Fain:

The Bank Policy Institute[1] is writing to express concerns about the Federal Deposit Insurance Corporation's resolutions last year of Silicon Valley Bank and Signature Bank, the FDIC's actions taken in connection with those resolutions pursuant to the systemic-risk exception under 12 U.S.C. § 1823(c)(4)(G), and the special assessment of insured depository institutions that the FDIC has implemented in a final rule to recover the FDIC's estimated $19.2 billion loss to the Deposit Insurance Fund, which continues to change following a 25 percent upwards adjustment in the quarter after adoption.[2]

Although we support the use of the systemic-risk exception in appropriate cases and appreciate the difficulty of bank resolutions, the recent resolutions and resulting assessment (the first levied to recover the costs of utilizing the systemic-risk exception) have revealed both a lack of transparency and substantive shortcomings in the FDIC's approach. Insufficient transparency regarding costly choices made by the FDIC undermines the critical goals of confidence, stability, and soundness in the banking system and undermines confidence in the FDIC's ability to resolve failing institutions. Further, some of the FDIC's choices during the resolutions appear to have

[1] BPI is a nonpartisan public policy, research and advocacy group that represents universal banks, regional banks, and the major foreign banks doing business in the United States. The Institute produces academic research and analysis on regulatory and monetary policy topics, analyzes and comments on proposed regulations, and represents the financial services industry with respect to cybersecurity, fraud, and other information security issues.

[2] 88 Fed. Reg. 83,329 *et seq*. The FDIC publicly disclosed a revised loss estimate of $20.4 billion in the FDIC's 2023 annual report. *See* FDIC, *FDIC Annual Report 2023*, at 140 (Updated Mar. 22, 2024), https://www.fdic.gov/about/financial-reports/reports/2023annualreport/2023-arfinal.pdf. The FDIC subsequently adjusted that estimate to $19.2 billion in its Quarterly Banking Profile for the first quarter of 2024. See FDIC, FDIC Quarterly Banking Profile First Quarter 2024 (May 29, 2024), https://www.fdic.gov/news/speeches/fdic-quarterly-banking-profile-first-quarter-2024.

needlessly increased—by billions of dollars—the FDIC's losses, and thus needlessly increased the amount of the assessment.

We have addressed this letter to you because nondisclosure agreements[3] and a general lack of transparency surrounding the FDIC process effectively block media, industry, and Congress from discovering how the process of resolving the failed banks has worked. The banking industry, members of Congress, and the public have raised concerns that the FDIC's process was flawed, but we have no ability to learn the underlying facts.[4] We submitted information requests to the FDIC pursuant to the Freedom of Information Act on March 15, 2024, but to date the FDIC has not responded, despite the statutory requirement that federal agencies must respond to FOIA requests within 20 working days unless unusual circumstances exist.[5] The FDIC is required by statute to maintain some of the information we have sought and make it available to members of the public upon request, but the FDIC still has not responded to our request for this information.[6] Therefore, we urge the OIG to investigate the concerns we raise and make public any findings; only in this way can Congress and a future FDIC consider better solutions with respect to resolutions, financial management, and policies and processes related to any future systemic-risk resolutions and resulting special assessments.

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[3] *See, e.g.*, Federal Deposit Insurance Corporation Confidentiality Agreement, https://www.fdic.gov/buying/loan/documents/confidentiality.pdf (Dec. 7, 2022).

[4] See, e.g., Jeff Huther, *The FDIC's Unusual Loan from the Federal Reserve*, ABA Banking Journal (Apr. 4, 2024), https://bankingjournal.aba.com/2024/03/the-fdics-unusual-loan-from-the-federal-reserve/; Polo Rocha, *Banks Knock FDIC Over Growing Tab for Last Year's Failures*, American Banker (Mar. 13, 2024), https://www.americanbanker.com/news/banks-knock-fdic-over-growing-tab-for-last-years-failures; Noah Buhayar, *FHLB Charged $285 Million to Wind Down Lifeline After SVB Failed*, Bloomberg Law (Mar. 12, 2024), https://news.bloomberglaw.com/banking-law/fhlb-charged-285-million-to-wind-down-lifeline-after-svb-failed; Letter from Senator Bill Hagerty to FDIC Chairman Martin Gruenberg regarding sale of Signature Bank's loan portfolio (Mar. 10, 2024), *available at* subscriber.politicopro.com/f/?id=0000018e-2b12-dba0-abcf-6f971bf90000; Antoine Gara, Stephen Gandel, and Joshua Chaffin, *Brookfield Chides US Bank Regulator for 'Secret' Auction of Housing Loans*, Financial Times (Dec. 11, 2023), https://www.ft.com/content/29c13fbc-0ee6-4755-a9ea-349d9ef7bc55; WSJ Editorial Board, *How the FDIC Rigged the SVB Auction*, Wall Street Journal (April 18, 2023), https://www.wsj.com/articles/fdic-nonbanks-silicon-valley-bank-sale-martin-gruenberg-609af47.

[5] 5 U.S.C. § 552(a)(6).

[6] Under 12 U.S.C. § 1821(d)(15), the FDIC is required to "maintain a full accounting of each conservatorship and receivership" and "with respect to each conservatorship or receivership to which the Corporation was appointed, the Corporation shall make an annual accounting or report, as appropriate." The statute further requires that, "any report prepared… shall be made available by the Corporation *upon request* to…any other member of the public" (emphasis added).

I. Unexplained Policy Choices

The FDIC failed to explain many of the choices it made in the special assessment rulemaking, which was imposed to recover the costs of protecting the uninsured deposits of Silicon Valley Bank and Signature Bank.[7] These unexplained policy choices misalign risk and costs and undermine the logic of the assessment, as well as create uncertainty regarding how the FDIC will approach future bank resolutions. First and foremost, the FDIC implemented an overly blunt approach that imposed costs based on the amount of uninsured deposits held by an institution, without any distinction among the different types of uninsured deposits. Further, the rule provided only a conclusory statement about why the assessment was based on uninsured deposits rather than the standard assessment formula.

A. Assessment Deposit Base

The final rule rejected commenters' recommendations that the FDIC exclude or otherwise adjust assessment eligibility for certain types of uninsured deposits, including collateralized deposits,[8] operational deposits,[9] and intercompany deposits.[10] Although collateralized deposits and operational deposits can be more susceptible to runs than insured deposits in certain circumstances, their characteristics—as recognized by interagency prudential requirements[11]—make them considerably less susceptible to runs in a general environment of low confidence in insured institutions.[12] Intercompany deposits are also less susceptible to runs, given the relationship between the depositors and the bank, as equity holders, subsidiaries, or affiliates sharing common ownership direct or indirect ownership. The FDIC presented no evidence that any of these types of deposits were running from the banks subject to the assessment in the wake of the failures of SVB and Signature.

The final rule nevertheless implicitly adopted the notion that only FDIC insurance would be sufficient to exclude deposits from or make adjustments to the assessment base. To explain its rejection of differential treatment for, by way of example, collateralized deposits, the FDIC asserted that "the presence of collateral does not fully mitigate run risk."[13] This observation fails

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[7] 88 Fed. Reg. at 83,329/3.

[8] *Id*. at 83,334/3–83,335/1.

[9] *Id.* at 83,335/1–2.

[10] *Id.* at 83,335/2–3.

[11] The banking agencies' liquidity coverage ratio regulations, for example, recognize that collateralized deposits and operational deposits are less susceptible to runs than other types of uninsured, wholesale deposits.

[12] *See generally* BPI Comment Letter of July 21, 2023, at 3–5 (explaining the stability-enhancing features of these types of deposits).

[13] 88 Fed. Reg. at 83,335/1.

to acknowledge the facts that "the presence of collateral" does at least partially mitigate run risk and that many jurisdictions require their deposits to be collateralized deposits to mitigate risk. It also fails to consider any of the factors that could inform the degree of mitigation, such as the nature and extent of the collateral. For example, the FDIC did not explain why each type of deposit must be fully included or fully not included in the assessment base, as opposed to adjusting the weight of different types of deposits on the basis of the risk that they pose. Stability is not binary—indeed, even FDIC insurance does not fully mitigate run risk—and treating causes of instability as binary prevents the FDIC from promoting healthy banking practices that limit risk. Penalizing stability-enhancing practices, such as providing collateral, and doing so in opaque ways that prevent institutions from discerning the FDIC's broader policy stances, is counterproductive.

The final rule's preamble also observed that collateralized deposits may "in certain types of resolutions . . . reduce the assets available to the FDIC as receiver to satisfy claims."[14] This rationale is flawed insofar as it presumes that collateral property would be on a failed bank's balance sheet without the secured deposit funding for it, which is unlikely. Moreover, even if that were a likely outcome, this rationale does not justify the FDIC's treatment of collateralized deposits. The statutory factors guiding how to apportion the assessment include consideration of "the types of entities that benefit from" actions taken pursuant to the systemic-risk exception.[15] Thus, the fact that the collateral mitigates the risk of a run is relevant; the fact that the collateral would not be available to satisfy claims of unsecured creditors in certain types of resolutions is not. In any case, treating collateralized deposits in the same manner as other deposits would be sensible only if the harm of asset reduction that collateralized deposits cause is approximately equal in magnitude to the countervailing reduction of run risk that such deposits offer. But the final rule did not even assert that the risk-enhancing and risk-reducing features of collateralized deposits are in equipoise, let alone attempt to justify that conclusion.

The final rule gave an equally perfunctory reason for failing to treat separately intercompany deposits,[16] and it entirely ignored our comment letter's observation that including intercompany deposits risked double-counting those deposits.[17] So too did the final rule ignore our comment that operational deposits should be treated differently because a depositor is "reasonably expected to hold [them] in support of its day-to-day operations, even in periods of stress."[18] Instead, the final rule provided unrelated observations about these types of deposits and

[14] *Id.*

[15] 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

[16] 88 Fed. Reg. at 83,335/2 ("There is no clear evidence that intercompany deposits are more stable" because "governance[] and decision making can differ between entities.").

[17] BPI Comment Letter of July 21, 2023, at 2, 7.

[18] *Id.* at 4.

indicated the FDIC would not make any changes to the methodology for the assessment base because it would change the distribution of costs relative to the proposal.[19]

The FDIC's choice to fashion the assessment without accounting for risk factors that attach to particular types of uninsured deposits is not merely inadvisable as a matter of sound regulatory policy, but also inconsistent with the FDIC's obligations under the Administrative Procedure Act. "[R]easoned decisionmaking" is "[t]he touchstone of" an agency's obligations.[20] Agency action that is "arbitrary[] [and] capricious" is unlawful.[21] Furthermore, "an agency must articulate an explanation for its action," and "conclusory statements will not do; an 'agency's statement must be one of *reasoning*.'"[22] The FDIC's conclusory decisions with respect to differentiating among deposit types—which did not respond to critical comments on these issues[23]—are arbitrary and capricious and therefore violate the APA. We urge the OIG to identify this violation and prevent its recurrence.

B. Methodology Rationale

The FDIC makes several unsupported claims in support of its assessment methodology. A better understanding of the validity of these claims is essential to proper congressional oversight and improving future FDIC decision-making. Although the FDIC stated that its intervention pursuant to the systemic-risk determination was meant to limit the effects of the bank failures across the banking industry and the financial system more broadly, the final rule targeted only insured institutions with large uninsured deposit bases. The FDIC stated that this was meant to, among other things, place responsibility for paying the special assessment on "the banks that benefited the most—banks of larger asset sizes and that hold greater amounts of uninsured deposits."[24] However, this reasoning is inexplicable and counterfactual for three reasons.

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[19] "[A]ny exclusion for a type of uninsured deposits from the special assessment base would reduce the amount of the special assessment for banking organizations that hold those excluded, uninsured deposits, and increase the assessment burden for all other banks holding other types of uninsured deposits. For this reason…the FDIC is not excluding any particular type of uninsured deposits from the assessment base for the special assessment." 88 Fed. Reg. at 83,335.

[20] *Pharmaceutical Research and Mfrs. of Am.* v. *FTC*, 790 F.3d 198, 209 (D.C. Cir. 2015) (citation omitted).

[21] 5 U.S.C. § 706(2)(A).

[22] *Amerijet Intern., Inc.* v. *Pistole*, 753 F.3d 1343, 1350 (D.C. Cir. 2014) (quoting *Butte Cnty., Cal.* v. *Hogen*, 613 F.3d 190, 194 (D.C. Cir. 2010)).

[23] *See, e.g.*, *Reytblatt* v. *Nuc. Regul. Comm'n*, 105 F.3d 715, 722 (D.C. Cir. 1997) ("An agency need not address every comment, but it must respond in a reasoned manner to those that raise significant problems.").

[24] 88 Fed. Reg. at 83,334/1.

First, the premise that large institutions disproportionately benefited from the FDIC's actions pursuant to the systemic-risk determination is not supported by the evidence proffered by the FDIC, which consists primarily of the data point that banks with assets between $50 billion and $250 billion experienced particularly severe declines in uninsured deposits in the first quarter of 2023—a quarter which, by the FDIC's own admission, saw industry-*wide* declines.[25] Meanwhile, the FDIC acknowledged that the size of an institution's deposit base was not necessarily correlated with declines in uninsured deposits in the first quarter, as it noted that declines in U.S. global systemically important bank deposits were *lower* than industry-wide declines, that there was a wide variance among the changes in uninsured deposits of GSIBs, and that the range of GSIB outcomes spanned from a bank that experienced a 2.6% *growth* in uninsured deposits to a bank that experienced a nearly 17% decline.[26]

Second, the FDIC failed to explain why "general" trends about institution size—with seemingly many exceptions—should form the very building block of the assessment base via the outright (and apparently arbitrarily chosen) exemption of $5 billion in uninsured deposits. Indeed, the $5 billion deduction is puzzling even on its own terms. The FDIC's data shows the percentage of assets supported by uninsured deposits at banks with between $1 billion and $5 billion in assets (27.9%) is almost identical to the percentage at banks with between $5 billion and $10 billion in assets (28.9%), with significant increases only in the $10+ billion range.[27] Similarly, the average ratio of uninsured deposits to total domestic deposits is comparable for banks with assets of $1 billion to 5 billion (33%) and $5 billion to 10 billion (35%), with more significant increases in the $10+ billion range.[28] Based on the FDIC's logic, it would make sense to use a threshold of $10 billion in assets because banks of this size have a higher percentage of uninsured deposits on average. A bank at the $10 billion threshold would on average have uninsured deposits of approximately $2.89 billion, rather than the $5 billion uninsured deposit deduction the FDIC actually provided. A $5 billion deduction thus appears to overcompensate for the concerns the FDIC articulated, compelling the conclusion that the threshold is either arbitrary or results-oriented.

Third, even if it is true that institutions with more uninsured deposits realized a greater benefit from the FDIC's actions, the allocation of the special assessment to just a portion of these banks cannot be reconciled with the contemporaneous determinations that the systemic-risk exception was necessary to stave off an economy-*wide* and system-*wide* disaster.[29] Statements by

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[25] *See id*. at 83,333/1.

[26] *Id.* at 83,341/1–2.

[27] *Id.* at 83,333.

[28] *Id.*

[29] *See, e.g.*, Joint Statement by the Department of the Treasury, Federal Reserve and FDIC (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23017.html (stating that

U.S. Treasury Secretary Janet Yellen indicate community banking organizations sought—and received—equal treatment to all other banks with respect to the FDIC's and Treasury's consideration of the systemic risk exception.[30] This evidence undercuts the FDIC's generalizations about the type of entities that benefited from the systemic risk exception. Moreover, the FDIC did not address our comments about why those generalizations were wrong.[31]

Agency action is arbitrary and capricious when the agency's explanation "runs counter to the evidence before [it]."[32] And mismatches between an explanation and the record before the agency raise the potential that the agency has offered "contrived reasons" for its policy decisions meant to shield the "genuine justifications" from "the interested public" and, accordingly, from accountability and public participation.[33] The final rule ignored available data and public comments that ran counter to the FDIC's position in the special assessment proposal. The final rule made winners of small banks and losers of large ones, instead of ensuring and promoting sound banking practices across the industry. We urge the OIG to identify these violations of the FDIC's rulemaking obligations and ensure greater accountability in the future. This is necessary to ensure the FDIC is properly carrying out its statutory authority to resolve institutions under the systemic risk exception and properly allocate the costs of the failures.

II. Lack of Transparency around Costly Financial Management Choices

The FDIC has not been transparent with respect to certain critical decisions that increased the cost of the resolutions and, therefore, the total cost of the resulting assessment.[34] Regardless

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actions were taken "to protect the U.S. economy" and "ensure that the U.S. banking system" continues to function).

[30] David Lawder and Douglas Gillison, *Yellen Promise on Community Bank Deposits Sparks Relief in Small-Town America*, Reuters (Mar. 22, 2023), https://www.reuters.com/markets/us/yellen-promise-community-bank-deposits-sparks-relief-small-town-america-2023-03-22/; David Lawder, *Yellen Vows to Safeguard Deposits at Smaller U.S. Banks, Intervene if Needed*, Reuters (Mar. 21, 2023), https://www.reuters.com/markets/us/yellen-promise-community-bank-deposits-sparks-relief-small-town-america-2023-03-22/.

[31] *See* 88 Fed. Reg. at 83,332/3–83,334/1.

[32] *Motor Vehicle Mfrs. Ass'n of U.S.* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

[33] *Dep't of Commerce* v. *New York*, 588 U.S. 752, 785 (2019).

[34] The only sources of information on the cost of borrowing are barebones public reporting and oblique references in congressional testimony. *See, e.g.*, Questions for the Record from Rep. Bryan Steil for the Honorable Martin J. Gruenberg, *Federal Regulators' Response to Recent Bank Failures: Hearing Before the Committee on Financial Services* (118th Cong., 1st Sess.), at 189 (Aug. 23, 2023) (Responses of Chairman Gruenberg).

of the extent of the FDIC's duties to minimize costs even in systemic-risk circumstances,[35] the FDIC owes the industry and interested public transparency regarding the basic choices it has made and the costs it has incurred.

A. Penalty-Rate Borrowing

The total cost attributable to the FDIC's decision to rely on high-cost, penalty-rate discount window borrowing has been estimated to be as much as $2.5 billion.[36] Both bridge banks borrowed money from the Federal Reserve at a penalty interest rate of 100 basis points above the discount window's primary rate. Some of the Federal Reserve loans were extended prior to the banks being placed in receivership, and some were extended after, "supported by an FDIC [corporate] guarantee of repayment."[37] The FDIC has not disclosed why it chose to finance the failed banks using these penalty-rate loans instead of seeking lower-cost funding. Nor has it or the Federal Reserve disclosed the reasoning or the legal basis underlying the penalty rate in the first place, especially given that the loans were backed by an FDIC guarantee. The penalty rate led to potentially billions of dollars in costs that the FDIC has passed along via its flawed special assessment rule to select members of the industry.

The FDIC has also not publicly disclosed what other sources of funding it considered and, if none, why it readily accepted a penalty rate that would so dramatically increase costs. An agency acts arbitrarily by overlooking "obvious" policy alternatives[38] or "artificial[ly] narrowing . . . options" it considers.[39] The FDIC's ostensible failure to even consider whether it could secure lower-cost funding via, for instance, a private lender is an oversight of an "obvious" alternative. Given the complete lack of public information about this decision, it is imperative that the OIG investigate the FDIC's actions and provide the public with a complete accounting

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[35] There is sound reason to think that the systemic-risk exception does not leave the FDIC unconstrained to incur whatever costs it wishes. Unfettered discretion to ignore costs would transgress the duties the FDIC owes to the DIF in its capacity as a holder of a subrogated claim in respect of the failed banks' deposits against the receiverships. *See* 12 U.S.C. § 1823(d)(3)(C). Furthermore, the systemic-risk exception by its terms waives only the least-cost constraints of § 1823(c)(4)(A) and not, for instance, the FDIC's duties to "maximize[] the net present value return from the sale or disposition of such assets" and "minimize[] the amount of any loss realized in the resolution of cases" in § 1821(d)(13)(E)(i)–(ii). *See id.* § 1823(c)(4)(G)(i).

[36] *See* Huther, *The FDIC's Unusual Loan from the Federal Reserve*, n.4, *supra*.

[37] Federal Reserve Balance Sheet Developments, Additional Information on Other Credit Extensions, Federal Reserve Board—Additional Information on Other Credit Extensions (updated Jan. 4, 2024), https://www.federalreserve.gov/monetarypolicy/additional-information-on-other-credit-extensions.htm.

[38] *City of Brookings Mun. Tel. Co.* v. *FCC*, 822 F.2d 1153, 1169 (D.C. Cir. 1987) (citation omitted).

[39] *Pillai* v. *Civil Aeronautics Bd.*, 485 F.2d 1018, 1027 (D.C. Cir. 1973).

for these costly decisions. Additionally, the OIG should consider if FDIC procedures should be enhanced to require seeking market terms on any transaction, including loans. For instance, it is possible that some combination of banks bearing the assessment burden could have offered better terms on FDIC-guaranteed loans than were received from the Federal Reserve.

B. Overly Complex Sale Structures

The FDIC selected complex structures for at least $33 billion of real estate asset pools that were apparently inconsistent with the FDIC's mandate to resolve failed banks in cost-efficient ways for the DIF.[40] By structuring some of these asset pools as joint ventures in which the FDIC would retain majority equity stakes[41] and insisting on onerous financing, approvals, and consent terms, the FDIC limited demand for these assets and thus inherently depressed their sale price. Although the FDIC cited its statutory mandate with respect to affordable housing under the Federal Deposit Insurance Act as the reason for the joint venture structure, it did not explain why the complex structures it chose were revenue-maximizing, cost-efficient, or otherwise optimal. The OIG should review this decision to determine if the FDIC appropriately considered costs. This is especially critical where, as here, assessed institutions who will pay the great majority of these costs are unable to evaluate the merits of these decisions based on the limited information provided to the public.

C. Increasing Loss Amounts

In addition to the two sources of excess costs identified in the previous sections, other, unknown factors have continued to contribute significantly to the resolutions' costs in ways the FDIC has been unwilling to explain. When the FDIC first announced the planned assessment in May 2023, it estimated losses from the resolutions attributable to the protection of uninsured deposits to be $15.8 billion.[42] Approximately six months later, the final rule in November 2023 cited losses of $16.3 billion attributable to protecting uninsured deposits.[43] Merely four months after that, in March 2024, such losses had swelled to *$20.4 billion*,[44] a 25% increase in just four months and a nearly 30% increase over the original estimate. Although the FDIC subsequently

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[40] As described in n.35, *supra*, invoking the systemic risk exception should not be viewed to completely eliminate the FDIC's obligation to consider costs in how it manages the receivership of a failed bank.

[41] *See* Press Release, *FDIC Announces Start of Marketing Process for $33 Billion Commercial Real Estate Loan Portfolio of Former Signature Bank, New York* (Sept. 5, 2023), https://www.fdic.gov/news/press-releases/2023/pr23071.html.

[42] 88 Fed. Reg. at 32,695/3.

[43] *Id.* at 83,331/2.

[44] *FDIC Annual Report 2023*, n.2, *supra*, at 140.

revised its estimate downwards slightly to $19.2 billion,[45] these large and ever-changing loss estimates require investigation and a detailed, public explanation.

Regardless of the reasons for the higher loss estimates, however, the FDIC must ultimately account for these significant changes through the APA's notice-and-comment process. The FDIC's dramatically higher estimate from the one in the final rule previews that the FDIC is likely to either have to extend the assessment period or impose a one-time special assessment at the conclusion of the assessment period, either of which must undergo notice and comment.[46] The APA requires that an agency give the public notice of a proposed rule and the opportunity to comment on it.[47] "The important purposes of this notice and comment procedure cannot be overstated."[48] They include "foster[ing] public participation and facilitat[ing] reasoned decisionmaking."[49] At bottom, notice and comment is an essential "procedure[] by which federal agencies are accountable to the public" and regulated parties.[50] If the assessment period and loss estimates in the final rule ultimately are insufficient to fully recoup the losses caused by the resolutions, the FDIC will have to amend the final rule's terms via notice and comment because agency action that "amends a prior legislative rule" is itself a legislative rule requiring notice and comment.[51] It is not sufficient that the assessment initially went through notice and comment and

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[45] *FDIC Quarterly Banking Profile First Quarter 2024*, n.2, *supra*.

[46] We also note that the proposed rule specifically stated that the FDIC "would not change existing reporting policies and procedures," and that future amendments to a bank's call reports "would not affect an institution's rate or base for the special assessments." 88 Fed. Reg. at 32,700/2. Parties who preferred this outcome had no reason to file comments advancing their view on the subject. Nonetheless, the final rule improperly "switched course and adopted the opposite position," *Env't Integrity Project* v. *EPA*, 425 F.3d 992, 995 (D.C. Cir. 2005), that certain amendments *would* be considered to adjust a bank's rate or assessment base, 88 Fed. Reg. at 83,336, 83,348/2–3. This violates the requirement that a final rule must "be a logical outgrowth of [the] notice" of the proposed rule in order to give commenters fair notice of what the agency is considering and ensure an effective notice-and-comment process. *CSX Transp., Inc.* v. *Surface Transp. Bd.*, 584 F.3d 1076, 1079–80 (D.C. Cir. 2009) (citation and quotation marks omitted).

[47] 5 U.S.C. § 553(b), (c).

[48] *North Carolina Growers' Ass'n, Inc.* v. *United Farm Workers*, 702 F.3d 755, 763 (4th Cir. 2012).

[49] *Humane Society of the U.S.* v. *U.S. Dep't of Agric.*, 41 F.4th 564, 568 (D.C. Cir. 2022).

[50] *Franklin* v. *Massachusetts*, 505 U.S. 788, 796 (1992).

[51] *Am. Min. Cong.* v. *Mine Safety & Health Admin.*, 995 F.2d 1106, 1112 (D.C. Cir. 1993).

disclosed the loss amount was an estimate subject to change.[52] If the FDIC wishes to recoup a different amount or extend the assessment period, it will have to undertake a new rulemaking process, including providing a full accounting of the losses the FDIC intends to recover.

Moreover, premature promulgation of the final rule, before the final loss amount was ascertained even within four billion dollars, means the FDIC necessarily failed to consider the full effects of the assessment on the industry—in violation of its statutory mandate. Subject to the APA's general reasoned decision-making requirement, Congress granted the FDIC certain discretion in tailoring an assessment following invocation of the systemic-risk exception, but "the effects on the industry" of any assessment is a factor that Congress *requires* the FDIC to consider.[53] The final rule dedicated two cursory paragraphs to this statutorily mandated factor. Those paragraphs rehashed the types of banks that would be affected rather than saying anything about the actual *effects*.[54] And forecasts the final rule gave elsewhere about, for instance, the Tier 1 capital and income of banks required to pay the assessment are also necessarily incomplete, at best, in light of significant changes in loss estimates that post-date the final rule.[55]

Given these severe shortcomings in the final rule, we urge the OIG to review the FDIC's actions and determine if any violations are ongoing. In particular, we believe the OIG must ensure that any increases to institutions' assessment amounts are carried out through the notice and comment process.

III. Proposals for Reform

The FDIC's lack of transparency in the resolutions removed an important element of accountability and assurance that the FDIC is making financial management choices consistent with its general mandate to act in a cost-efficient way. Even with the lack of visibility into FDIC decision-making, it appears that the approach to the resolutions created unnecessary losses for the DIF and then misallocated those losses among industry participants. To help avoid these problems with future resolutions, and to ensure continued public confidence in its ability to resolve banks in an orderly manner, the FDIC should consider the benefits of leveraging risk management expertise within the banking industry through a standing industry advisory panel to advise the FDIC on setting its investment policies and other matters related to the FDIC's mission, including risk management during exigent circumstances. The FDIC should also be open to additional reform proposals that may emerge from a thorough investigation of the

[52] *Cf. United States* v. *Picciotto*, 875 F.2d 345, 347 (D.C. Cir. 1989) (holding that an agency cannot "grant itself a valid exemption to the APA for all future regulations, and be free of APA's troublesome rulemaking procedures forever after, simply by announcing its independence in a general rule").

[53] 12 U.S.C. § 1823(c)(4)(G)(ii)(III).

[54] 88 Fed. Reg. at 83,341/2–3.

[55] *Id.* at 83,333/1–2, 83,342/1–3.

resolutions, and we reserve the right to supplement these requests as additional information becomes known.

A. Least Cost under the Systemic-Risk Exception

Even under systemic-risk circumstances, the FDIC should adhere to least-cost principles to maximize returns and minimize losses to the DIF. Although a systemic-risk exception may permit some deviation from absolute cost minimization in terms of protecting uninsured deposits, the logic of the principles remains intact: a DIF funded by captive institutions should not be treated as a blank check to fund expensive, poorly explained (and perhaps ill-conceived) initiatives.[56]

In striving to operate in accordance with least-cost principles, the FDIC should consider what could go wrong in the course of pursuing particular methods of resolving banks. Specifically, if a given course of action is expected to be lower cost than another strategy, but such a course of action contains significant downside risk (from the DIF's perspective), such that total cost may ultimately be excessive, then the tail risk should be considered in the FDIC's assessment of "least cost." Such considerations may rightly cause the FDIC to pursue a strategy that is not least-cost in the short term in order to limit potential cost borne by the DIF and the insured institutions ultimately funding it.

B. Advisory Committee

We strongly recommend the FDIC immediately request that the Systemic Resolution Advisory Committee (SRAC) investigate and address these important matters and begin preparing for future systemic-risk resolutions and subsequent assessments. The SRAC, whose membership could be supplemented as needed for this important task, could advise the FDIC as to deploying risk management approaches in the execution of systemic-risk resolutions. So armed, the FDIC would find itself more able to achieve its objectives of promoting a stable banking industry while acting in accordance with the least-cost principles that are central to the FDIC's mission.

The advisory committee model is commonly used by financial regulators and government agencies to leverage industry expertise in executing narrowly focused agency functions.[57] Indeed, SRAC members have considerable experience in risk management and asset disposition. Because losses resulting from the FDIC's financial management choices are eventually mutualized through DIF assessments (either among all banks or, as in this case, banks selected by the FDIC), industry representatives also have a legitimate interest in the proper risk management of the FDIC's funds and could be added to the SRAC as appropriate.

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[56] *See* n.35 *supra*.

[57] *See, e.g.*, FDIC, FDIC Advisory Committees, https://www.fdic.gov/about/advisory-committees/; Federal Reserve, Advisory Councils, https://www.federalreserve.gov/aboutthefed/advisorydefault.htm.

C. Enhance Transparency of Bidding Process

The OIG should consider if there are ways to further enhance transparency around the FDIC's process for resolving failed banks and, in particular, the bidding process administered by the FDIC. In particular, the OIG should consider the role and scope of the FDIC's use of nondisclosure agreements. On the one hand, these NDAs are essential insofar as they ensure confidentiality for bidders and protect proprietary and commercially-sensitive information about banking assets and business operations offered for sale. On the other hand, by restricting parties from disclosing even general, non-commercially sensitive information about the bidding process, the agreements inhibit any effort to independently assess the FDIC's performance in doing its job, thereby also precluding the opportunity to identify and implement future process improvements. Thus, the OIG should review the use of NDAs in the bidding process and seek to identify whether there are adjustments or changes in their use that would preserve their utility and value but also allow for more transparency and accountability *ex post*.

D. Provide Forward-Looking Clarity on Special Assessments

As demonstrated above, it is unclear what effects or impacts the FDIC considered to be "benefits" for purposes of the statutory criteria of allocating the costs of the systemic risk exception, and what types of benefits will be taken into account in any future special assessments. We believe the OIG should recommend that the FDIC identify the types of benefits, both direct and indirect, the FDIC will consider and the types of information and data that it will consult in determining which institutions benefit from any future use of the systemic risk exception. This exercise would provide transparency and predictability in the structuring of any future special assessments. Banks, Congress, and the public should have an understanding of how the FDIC will approach future special assessments, even if those assessments are ultimately imposed to respond to idiosyncratic or unusual events and must be tailored to reflect the circumstances of those events. Even if some aspects of future special assessments cannot be determined in advance, a robust, public discussion of the process will enable any future FDIC actions to be fair, appropriate and imposed in a manner that reflects the factors set forth in the statute.

IV. Conclusion

We all benefit from a regulatory agency that can react quickly, transparently, and in a disciplined manner to protect the banking system from a systemic-risk event. But the recent actions taken by the FDIC in managing receiverships for Signature Bank and Silicon Valley Bank lacked the discipline, transparency, and sound policy decisions that the banking industry and American public deserve to rely on in uncertain times. We hope this letter provides the OIG ample reason to inquire into the FDIC's decision-making, and that the letter provides a guide to the FDIC for better transparency and accountability in any future systemic-risk scenario.

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We appreciate the OIG's consideration of the points in this letter. If you have any questions, please contact me by email at greg.baer@bpi.com.

Respectfully submitted,

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President and Chief Executive Officer
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cc: FDIC Chairman and Board of Directors